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Preface

In May 1984 the Ontario Economic Council hosted a conference entitled *Ottawa and the Provinces: The Distribution of Money and Power*. The purpose of the conference was to begin to lay the groundwork for the 1987 revision of the federal-provincial fiscal arrangements. A range of issues reflecting the very broad nature of the fiscal arrangements was addressed (e.g., equalization, health care, postsecondary education, welfare, the Canadian economic union, and the structure and processes of federal-provincial relations). In addition, sessions were devoted to various perspectives on the fiscal arrangements – historical, regional, and international.

This discussion paper covers the the conference session devoted to regional perspectives on the fiscal arrangements. The authors (from different regions and from different political backgrounds) were invited to share their views on federal-provincial relations hopefully, but not necessarily, from the vantage point of their regions. Each of these authors brings a wealth of knowledge and experience to the analysis of federal-provincial finances. The response to the presentation of their papers was so overwhelming that the Council decided to publish them as a separate piece in advance of the full conference proceedings. On behalf of the Council, I would like to thank Mr. Romanow, Mr. Ryan, and Mr. Stanfield for co-operating so fully with this publication schedule.

With this discussion paper the Ontario Economic Council is embarking on a new publication series, devoted to federal-provincial fiscal relations. Later publications in the series will include the full

Ottawa and the Provinces: Regional Perspectives

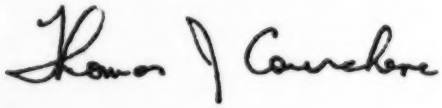
Roy J. Romanow
Claude Ryan
Robert L. Stanfield

Ontario Economic Council
Special Research Report

Federal-Provincial Relations Series

conference volume, a monograph on equalization payments, and a monograph on the politics of federal-provincial relations. We trust that these publications will provide Ontario and Ontarians with valuable background and insight as we move toward the 1987 round of negotiations relating to the financing of our federation.

As is the case with all our conference proceedings, the views expressed are those of the authors and not necessarily those of the Ontario Economic Council.



Thomas J. Courchene
Chairman,
Ontario Economic Council

Fiscal arrangements: a Western perspective

Roy J. Romanow, Q.C.

> A major overhaul of the fiscal arrangements is tantamount to a change in the Constitution itself.
>
> – Thomas J. Courchene

Tom Courchene (1979, 3) is right. If a nation's constitution gives it shape and definition, then it certainly runs on its fiscal arrangments. Thus, any examination of relations among Canadian governments would be incomplete without a study of the impacts of both their constitutionally derived powers – legislation, taxation, regulation – and their financial relationships. Fiscal arrangments cannot be separated from jurisdictions or constitutional negotiations; neither can they be understood outside the context of federal-provincial relations.

I will begin with an examination of that context, of the trends that underlie recent developments in Canadian federalism. I will then consider fiscal arrangements within the changing character of the federal system, looking at both the negotiations that surrounded the 1976-7 and 1981-2 agreements on established programs funding (EPF) and those concerning the 'powers-over-the-economy' proposals made during the constitutional debate of 1980. Next will come a look at the ways in which international economic forces and domestic strains on our federal system affected these negotiations. The responses to these problems, both existing and potential, clearly suggest the basic questions: what kind of fiscal federalism do we want? do we need? I will conclude by advocating a changed approach to fiscal federalism – and to Canadian federalism generally – and suggest

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some reforms that should be investigated.

THE CONTEXT

To better understand current trends in federal-provincial relations, we must place recent developments in context.

The new federalism

Canadian federalism has changed dramatically since 1980, when Prime Minister Pierre Trudeau and a majority Liberal government came back to power, marking the advent of what is termed the New Federalism. This approach to federal-provincial relations was described, in government circles in Saskatchewan at the time, by the phrase 'the centre strikes back' – or 'the centre cuts back', depending on what mood we were in.

When the Trudeau government was re-elected in 1980, it appeared to have three major objectives:

1 To defeat the forces of separatism in Quebec.
2 To shift the balance of power from the provincial governments to the federal government.
3 To institutionalize this new balance of power, in large part through constitutional reform, so that it would never again shift to the provinces.

Today, the first objective has been achieved, however temporary that victory may be and however much one may debate the role the federal government actually played in the outcome of the referendum in Quebec. The second objective – to move the pendulum of power from the provincial governments towards the federal government – is well advanced. The federal government is 'striking back' in areas of federal jurisdiction and control and in traditional areas of provincial taxation. It is also 'cutting back' on traditional federal funding to provincial governments. The third objective – to institutionalize this new balance of power – is only partly achieved. During the constitutional debates, the federal government's initiatives, which many saw as a double-edged strategy of attempting to overcome the regional economic cleavages presented by an increasingly wealthy Western Canada and the cultural/ethnic cleavages presented by

Quebec, met with mixed success. It failed with specific constitutional proposals to strengthen its hand in such areas as resources and powers over the economy, but the Charter of Rights was entrenched. Clearly, the question of institutionalizing the new balance of power within the Canadian nation is only partly resolved, and I think it will be on the public agenda for some time.

Yet there is no question of where the pendulum has swung. For example, the unilateral imposition of the Petroleum Administration Act and the National Energy Program in 1980 set prices and introduced taxes within traditional areas of provincial taxation, disrupting the generally understood division of the fields of activity of the two levels of government. Although the legislation was *intra vires* within federal jurisdiction, its political effect was to 'squeeze' the provinces' tax room, pressuring them to reduce their own resource taxes and royalties and, in effect, to readjust their own social, economic, and political objectives. In other words, the federal spending power was used to obtain leverage in areas thought to be very important to provincial governments, especially those of Western Canada.

The shift of power is also shown by cutbacks in federal funding to provincial governments. Federal transfers to provincial governments have been replaced, in some areas, by the direct delivery of federal programs, bypassing provincial treasuries. This shift reflects the federal government's view that it is not getting its fair share of credit or visibility for the funds it spends through shared-cost programs and fiscal arrangements.

The shift from co-operative federalism

The New Federalism has also been characterized by litigation rather than negotiation, by unilateral rather than co-operative actions, and by confrontation rather than consultation.

Such was not always the case in federal-provincial relations. The co-operative federalism of the postwar era was a sharp contrast. Marked by a willingness to accommodate, by innovative social policy, and by federal-provincial cost-sharing, it was a reflection of the times. Economic growth, coupled with broad agreement on societal goals, enabled the development of a national pension plan, a national hospital plan, Medicare, and other programs associated with the maturation of the welfare state in Canada.

As economic growth slowed during the 1970s, the consensus of the postwar era began to erode. Widespread agreement on public policy was replaced by questioning of the welfare state; concern shifted from redistributing national wealth to producing it. In the early 1980s, economic recession and attendant government restraint produced vigorous debate concerning the universal coverage of social programs. Meanwhile, the political climate had changed with the challenges posed by the presence of the Parti Québécois and the agitation of the 'new West'.

One can understand why the federal government, faced with this changed economic, political, and social environment, felt that it had to react as it did. For example, the rapid growth of natural-resource revenues in the 1970s was reflected in the increasing provincial share of total government revenues. Yet federal transfers to provincial governments were also increasing. Moreover, the decentralizing influence of co-operative federalism, coupled with growing economic clout, enabled provincial governments to pursue economic diversification aggressively or to engage in province building. (For a discussion of province building in Alberta and Saskatchewan, see Richards and Pratt [1979].) Diminished federal involvement in social programming and the loss of visibility that accompanied the demise of shared-cost arrangements assisted the transfer of political loyalty from the federal to the provincial governments with a corresponding blow to 'national unity'.

Threats by some provinces to opt out of tax-collection agreements seemed to endanger the economic union. Receiving even more public attention were the threats to the political union – the election of a separatist government in Quebec and the spread of alienation in the West. The sense that province building, decentralization, and the growth of provincial power would continue unabated was prevalent not only in Ottawa but also in many other parts of the country. The consequences of these trends were and still are seen as dangerous. Prime Minister Trudeau, in a speech at Laval University on 30 March of this year, noted that when provinces became spokesmen for the regions, they 'eroded the moral and political authority of the Canadian government to speak for people from all regions of Canada' (1984).

Given all these pressures, one can understand why the federal government felt that it had to react; what is less clear is why it

overreacted. Perhaps it overestimated the extent of provincial power and resource revenues. Rather than achieving a balance, the New Federalism has succeeded only in tipping the scales in the other direction.

FISCAL ARRANGEMENTS

The dynamics in Canadian federalism have shaped and animated the negotiations surrounding federal-provincial fiscal arrangements, particularly the sets of discussions concerning established programs funding (EPF).

The EPF negotiations of 1976-7

At the Conference of First Ministers in June 1976, Prime Minister Trudeau outlined five principles for EPF:

1 The federal government should continue to pay a substantial share of program costs.
2 Federal payments should be calculated independently of provincial program expenditures.
3 Federal contributions to the provinces should be more nearly equal in per-capita terms.
4 The arrangements for the established programs (hospital insurance, medical insurance and postsecondary education) should be placed on a more permanent footing.
5 Provision should be made for continuing federal participation in the development of policies of 'national significance' in health and postsecondary education.

In retrospect, it was a remarkable proposal. With the agreement of the subsequent year, it represented the apex in the decentralist era of co-operative federalism. From the first Fiscal Arrangements Act of 1961, the federal government had been a partner in the policymaking process for the Medicare and hospital insurance programs. The 1976 proposal was an attempt to disentangle the roles of the federal and provincial governments in these fields. The attempt to return to the watertight compartments of classical federalism (if such ever existed) was an act of courage, given the federal-provincial interdependence of the mid-1970s.

The need to alter the arrangements was, however, obvious to most of the governments involved. The federal government disliked the open-ended nature of shared-cost programs. The EPF arrangements of 1977 sought to make federal transfers predictable and to give the provinces the opportunity to undertake long-term expenditure planning. The provincial governments disliked the inflexibility of the shared-cost arrangements, which made federal money available for some services and not others. Hospital and surgical services were covered; preventive medicine and nursing homes were not. Innovative health care services could be provided only at full provincial expense. The 1977 arrangements disassociated federal payments from program costs by replacing cost-sharing with tax 'points' and cash (block) grants.

It is worth noting that the government of Saskatchewan had favoured the retention of cost-sharing, feeling that it was more consistent with the co-operative federalism the province advocated. At the First Ministers' Conference on the Economy in 1977, Premier Allan Blakeney spoke against the block-funding arrangements. One of the arguments he advanced concerned the federal government's important role in protecting universal social programs. He also accurately predicted that the federal government would lose visibility and political credit for its contributions under the new arrangements.

Nevertheless the die had been cast. The 1977 agreement was finally struck when the provinces were given a revenue guarantee in exchange for terminating open-ended cost-sharing under the Hospital Insurance and Diagnostic Services Act (HIDS).

The EPF negotiations of 1981-2

The next round of EPF negotiations, in 1981-2, reflected the changed environment of federal-provincial relations. Most provinces wished to extend the existing equalization and EPF arrangements. The federal government, however, was upset at the lack of visibility of its expenditures and disliked its lack of influence over the programs funded via EPF. Economic circumstances had changed as well. As part of its battle against the recession, the federal government wished to cut back on its fixed cash payments to the provincial governments.

In 1981, Ottawa announced that it would place 'national standards' or program conditions on Medicare through a new health act and would pursue 'national objectives' in financing postsecondary

education. The government of Saskatchewan supported the health-program review and pressed for a strengthened national health-care system that included an enforcement mechanism. The other provinces objected, however, and negotiations came almost to a standstill. The federal government threatened unilateral cuts (in effect, a freeze at 1982 levels) if agreement was not reached by 31 March 1983.

Thus, although the provincial governments believed that the revenue guarantee had been a *quid pro quo* for their having agreed to terminate HIDS, the federal government ended it in 1982. It also succeeded in cutting back on its cash transfers, in 1983, by splitting its grants between health care and postsecondary education and capping its contributions to the latter. And with the Canada Health Act, it is once again involving itself in the policy side of social programming and setting program conditions for federal funding.

In brief, the EPF negotiations of 1981-2 bear the marks of the New Federalism. In my judgement, the federal government never seriously attempted to renegotiate the 1977 agreement. The period of co-operative federalism was over. The federal government did not consult the provincial governments prior to announcing changes. And, to be fair, the provincial governments did not consult the federal government prior to making changes to health-care programs covered by the agreement.

ECONOMIC UNION

The same dynamics were at work on another front – the debate over federal 'powers over the economy' during the constitutional negotiations of 1980. The centre was striking back on many fronts.

In July 1980, at a meeting of the Continuing Committee of Ministers on the Constitution, the federal government tabled a discussion paper titled *Powers over the Economy: Securing the Canadian Economic Union in the Constitution* (Canada 1980). It suggested that constitutional safeguards be introduced for the economic union by barring 'undue impediments' to the free interprovincial movement of people, goods, services, and capital. The stated rationale was improved economic efficiency, which would make Canada better able to compete in the international marketplace.

The discussion paper identified threats to the economic union as stemming from provincial governments' preferential purchasing policies, from the proliferation of provincial subsidies to business, from land ownership laws in Prince Edward Island and Saskatchewan, from preferential hiring policies or quotas on workers hired from other provinces, and from discriminatory provincial pricing policies. To rectify the situation, it argued, we need constitutional safeguards, enlarged federal regulatory powers, and, last but not least, more co-operative arrangements among governments.

A Western view of economic union

To a Prairie boy like myself, the idea of a completely unfettered economic union in Canada is an odd concept. Barriers to the free movement of goods and services, such as protective tariffs, were a fundamental cornerstone of the old National Policy, necessary to ensure that the central Canadian heartland could secure and hold markets in the outlying regions. A sheltered industrial complex in central Canada needed both a populated agricultural hinterland to consume its products and tariffs to blunt the competition from the mid-west and eastern United States and to encourage Canadian industry. Euphemistically, the goal was known as fostering interprovincial trade in the national interest.

You have heard the litany of Western alienation before, but I believe it is still relevant. The National Policy provided no scope for industrial expansion in the West. High tariffs and subsidies linked to rail-freight rates that encouraged central Canadian manufacturing, together with world-market pricing of agricultural products and a two-price system for Canadian grains, mitigated against a Western manufacturing sector. As political economist Vernon Fowke put it so well: 'The prairie economy grew up in a pre-established framework of tariffs, which shaped, limited and curtailed its development' (1957, 67).

The result of the National Policy was predictable in my region of the world. Without a diversified base, the Prairie economy is unstable, subject to booms and busts, unhealthily reliant on export-oriented agriculture and the shifting conditions of international markets. Perhaps unfairly, many Westerners are conscious of their resources – oil, grain, uranium – being sold below world prices in

Canada while no attempts are made to sell iron ore, gold, copper, or asbestos at less than the world prices. There is no export tax on electricity, as there is on oil.

So in 1980 the West saw no crisis of the economic union, certainly none that warranted a constitutional provision of the kind the federal government was suggesting. Neither did a juridical solution seem required. It seemed that Ottawa was ignoring the impacts of its major economic levers, such as tax rates, tariffs, and transportation policy, although their effects on the economic union were far greater than those of the threats identified in the discussion paper. Neither was it obvious that the courts were well equipped to deal with matters requiring economic judgement.

From Saskatchewan's perspective, it appeared that the 'federal proposal would unduly limit the capacity of a province to pursue its legitimate role' in managing the provincial economy and would place 'in the hands of the courts critical economic decisions' (Romanow 1980). Certainly, the proposal, if implemented, would have had significant impacts on Saskatchewan. We were advised that it would probably have struck down the laws that restrict nonresident ownership of farmland, which are designed to protect family farms and prevent them from becoming yet another investment vehicle for mutual funds. Affirmative-action plans for long-term residents of northern Saskatchewan, most of them of Indian ancestry, would not likely have met the test either.

Although the federal initiative had the laudable objective of achieving a greater degree of economic integration and increased mobility of financial and human resources, the approach was heavy-handed and overreactive, another early example of the New Federalism.

FORCES AND STRAINS

In its 'powers-over-the-economy' proposal of 1980 and in its 1981-2 EPF negotiations, the federal government was not reacting solely to inter-regional economics of politics. There are forces at work, many of an international character, that challenge fiscal federalism and, indeed, our entire federal system. Among the most obvious are the centralizing tendencies of the international market, of modern communications and technology, and of growing economic scarcity.

Centralizing forces: theory and fact

International economic forces, many analysts have assumed, present a long-term threat to federalism. The move towards world-product mandates for international trade, the new competition from Third World nations, and the rise of nontariff barriers and increased national protectionism would all lead to the centralization of federal states. Regional differences would gradually vanish with the full development of the modern international economy. In a world of unbridled competition, regional concerns such as the territorial redistribution of income would have to yield to the overall concern of the production of wealth.

Moreover, said the analysts, space-age communications and high technology present a similar centralizing push. The growth of worldwide multinational corporations with their requirements of international communications, banking, and labour, their demands for international standards in education and training, and their need for technological compatibility of data processors, would eventually overwhelm a federal state.

Yet high technology, space-age communications, and international competition have not significantly diminished Canada's regional and linguistic cleavages. Indeed it can be argued that a third force of international proportions – economic scarcity – has only served to reinforce them. Scarcity appears to have a fragmenting effect in all highly complex societies, whether it be the Basques of Spain, the Bavarians of Germany, the citizens of the American sagebrush states, or the Westerners of Canada (see Hueglin 1984). Increased scarcity renders territorial and socioeconomic conflicts all the more salient. It has highlighted Canada's differentiated regional economies, its centre-periphery disparities, and its socioeconomic inequities. The branch-plant economy becomes all the more vulnerable when hit with both an economic downturn and increased protectionism.

These forces strain the responsive capacity of any nation-state, let alone a federal nation-state. Some people argue that such a hostile international economic environment requires a more efficient and, therefore, centralized federal system. Indeed, the New Federalism can be viewed as such as response.

The impact of hard times

Certainly, the diminished economic circumstances of the early 1980s had an impact on the fiscal-arrangements negotiations and economic-union debates. Government restraint in the public sector, coupled with a growing questioning of universal social services and increased suspicion of the welfare state, led many Canadians to call on the federal government for strong economic leadership. A harsh setting makes unilateral action, cutbacks, and arguments for greater federal powers over the economy seem more acceptable to many people. In a period of perceived economic crisis, there is a natural response of looking to the federal government for leadership. (Recall that the Supreme Court of Canada, in its decision on the Anti-Inflation Act reference in 1976, said that in times of economic crisis amounting to an emergency, the federal government has the power, under the 'peace, order and good government' clause of the Constitution, to control profits, prices, and wages.)

Thus, the current international economic circumstances can provide a federal system such as Canada's with the opportunity to centralize power without addressing problems of regional tension and alienation. Alternatively, such circumstances can provide the opportunity to increase economic integration on the basis of federal-provincial co-operation, reflecting regional economic differences within a national framework.

RESPONSES

Given the forces at work in Canada – the history of fiscal arrangements, the broader issues of federal-provincial relations, the thrusts of the 'new' Quebec and the new West, the pressures of resurgent protectionism, technology, and international economics – what kind of federalism is appropriate? How might fiscal federalism adapt in this changed environment?

New federalism and co-operative federalism

The response of the federal government, to date, has been the New Federalism. Refer again to the prime minister's speech of 30 March. He spoke of the need to strengthen internal cohesion and external unity, of greater economic solidarity within a stronger

Canada - objectives on which there appears to be agreement. He compared the federal system to the human body, with the federal government as the head and the provincial governments as the arms. While the head cannot do the work of the arms, he said, the arms cannot work effectively without 'the overall view that the head alone can provide' (Trudeau 1984). An interesting, and perhaps telling, analogy. Note that it is not one of the federal and provincial governments' linking arms and working as a team under the leadership of a federal captain.

One senses in the prime minister's speech, as in the EPF negotiations and the debate over the economic union, that the response of the federal government to today's stresses and strains is further centralization of the federal system. Outside the federal cabinet, it would seem, this view is not widely held.

The Parliamentary Task Force on Federal-Provincial Fiscal Arrangements spent considerable effort examining how fiscal federalism might adapt to the changed environment and consulting fellow Canadians on the question. In its report, titled *Fiscal Federalism in Canada*, the Task Force concluded: 'Citizens demand an effective co-operative federalism' (Canada 1981).

Moreover, the task force report does not advocate greater centralization. It is more sympathetic to the model of co-operative federalism, with its joint federal-provincial planning, its overlapping and ravelled relations, and its interdependent and inter-related dynamics. The report acknowledges that the classical federalism of watertight compartments, should it ever have been attainable, is an unrealistic objective in today's economic environment. Furthermore, the Canadian union is more than economic; it is social and cultural as well. Clearly, perfect compartmentalization in this kind of situation is virtually unattainable and probably not even desirable.

The lessons of previous negotiations

If increased centralization is not an appropriate response and if citizens demand effective co-operative federalism, what kind of fiscal federalism is required? Some of the answers may be found in looking back over the negotiations on fiscal arrangements. (As a Saskatchewanite, I am in an interesting position to look back. During the negotiations of the 1977 EPF agreement, Saskatchewan was a

'have-not' province and received equalization payments. By the time of the 1981 negotiations, it was a 'have' province.)

In a very real sense, equalization is a demonstration of the balanced federalism I advocate. Although some people argue that our system of equalization should be fraternalistic rather than paternalistic – that is, that transfers should take place among provinces rather than from the federal government to provincial governments – the current arrangements suit the Canadian situation well. What can be argued with greater vigour is that the national objective should be to achieve greater equality among the regions, not merely permanent equalization among them.

There are lessons to be learned from the negotiations surrounding the fiscal arrangements. Provincial governments have needs, and federal governments have needs. On one hand, fiscal arrangements must allow provincial governments to experiment with innovative social programs. Fiscal arrangements must be predictable enough to allow provinces to prepare long-range expenditure plans. And arrangements must be flexible enough to permit provincial variation in the programs covered. On the other hand, fiscal arrangements must also allow the federal government to control its costs and to receive appropriate recognition for its expenditures. They must allow the federal government access to the policy fields covered and permit it to protect the universal social programs, which it established, through national standards and enforcement mechanisms. Fiscal arrangements must also be accountable.

There are also lessons to be learned from the constitutional debate on the 'powers-over-the-economy' initiative. A suggestion put forward by the government of Saskatchewan comes to mind. It called for the federal and provincial governments to commit themselves to the effective operation of the economic union by establishing an on-going review and assessment of its performance and having the responsible ministers at both levels work together to resolve outstanding problems. Such a review, it suggested, could cover all government policies that affect the mobility of resources in Canada, such as those concerning spending and taxation (Saskatchewan 1980). Shortly afterwards, the provincial finance ministers engaged in EPF negotiations proposed an intergovernmental 'code of conduct' as a means of dealing with the same problem within the Canadian common market.

The need for imperfection

Canada's economic union is less than perfect, but that is part of the price we pay for living in a federal state. Our unique governmental arrangements are designed to accommodate our diverse languages, regions, and cultures. A perfect economic union would not allow for the differences that are necessary in order to promote regional development and to provide opportunities for *all* Canadians. Although we must not allow barriers to threaten our economic union, we must allow for these differences.

The same is true of our social, cultural, and linguistic union. If it were perfect, it could not accommodate the needs of Quebec or the aspirations of our aboriginal peoples. As a federal nation, our objective – pursuing harmony while allowing diversity – must be achieved by less than perfect unions.

CONCLUSION

The New Federalism offers one vision of Canada. There is another vision that is more sensitive to regional differences and aspirations, that takes more cognizance of the need for flexibility and accommodation within our federal system. It accepts trial and error, the process of negotiation and compromise, a give and take in which the day ends with some harmonization, some symmetry. In a sense, it reflects this country itself with its vast geographic area, its cultural and linguistic differences, its diverse regional economies, and its 25 million citizens. Such great differences do not lend themselves to a single national policy or to a centralized federal state.

Our history is one of struggling to bring together diverse cultures, regions, and languages. To keep the Canadian miracle alive, we must achieve a balance between federal and provincial powers. This is why the New Federalism is not likely to work. It is not balanced. It alienates Quebec, the West, and, to some degree, the Atlantic region. We need a balanced federalism that reflects our search for harmony in diversity and that is built upon federal-provincial co-operation and accommodation – still an attainable goal notwithstanding the new pressures.

The interdependence of federal and provincial governments necessitates federal-provincial co-operation and co-ordination but not centralization. Indeed, it is argued quite forcefully, governmental

interdependence makes a single national economic development policy quite unworkable; what is needed is greater decentralization (Hueglin 1984). Conflicts arising from the structural crisis of central Canadian industry, the declining economy of Atlantic Canada, the nationalism of Quebec, and Western alienation cannot be reconciled by an omnibus national policy. Political union can be maintained, the argument goes, only by a strategy of regional self-sufficiency or of regional specialization and multilateral co-ordination, difficult and awkward as that may be. Thus, our Canadian system of intergovernmental bargaining becomes a source of strength, rather than weakness. In this regard, Canada may be a model case of political accommodation.

In such an interdependent federal state, neither level of government can act unilaterally in the long run. The debate over the Constitution proved the need for balance. Centralization is not the inevitable consequence of progress, and it cannot overcome the root of the problem, which is regional economic fragmentation.

At the national level, balanced federalism requires leadership, not unilateral actions. Some reforms may, therefore, be needed to enable greater regional input to national decision-making. Proposals for an elected Senate, for proportional representation in the House of Commons, and for provincial input to Supreme Court appointments are recent examples of worthwhile suggestions. Perhaps more attention should also be directed to proposals for reforms in the House of Commons: further study might be made of separating votes of nonconfidence from expressions of regional opinion, of the use of nonparty (free) votes on subjects of great regional interest, and of the use of Commons committees to achieve more regional input.

Another important area for reform is that of the conduct of intergovernmental relations. Certainly we need regular meetings of first ministers, finance ministers, and their officials. But the reform movement must re-evaluate what is termed 'executive federalism', that process of reaching intergovernmental agreements behind closed doors without involving or answering to the Canadian public. Intergovernmental relations must become more open and more accountable – in a word, more democratic.

In the negotiations surrounding both the fiscal arrangements and the Constitution, executive federalism produced an overwhelming concern with government power and finances, with mechanisms and

structures. However, the public hearings attached to both sets of negotiations reflected an overwhelming concern with public policy, government services, and the rights of individual citizens; the finer points of the division of powers and the transfer of tax 'points' did not loom large. The need for a broader expression of the public interest in federal-provincial negotiations has never been clearer. Reforms in intergovernmental relations are required to encourage greater public participation (perhaps through public hearings of intergovernmental committees and task forces) and to enable greater accountability to legislatures and Parliament.

Through intergovernmental relations we have achieved accommodation, co-operation, co-ordination, and, for better or worse, interdependence. A reformed intergovernmental process could once again bring the participants to search for compromise and agreement.

A balanced federalism is not imposed unilaterally. It is negotiated, achieved through accommodation, reached by taking the middle road. This is the road we must follow.

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Federal transfer payments: a Quebec perspective

Claude Ryan

One of the most important functions of the federal power in our system of government is ensuring an equitable and efficient distribution of wealth and opportunities among the citizens of all provinces irrespective of differences arising from geography, history, ethnic origin, language, political allegiances, social status, and so on.

Since the end of the Second World War, the federal government has acquitted itself impressively in the performance of this task. The evidence lies in the many income redistribution programs introduced by Parliament. According to data contained in the last federal budget, transfer payments to individuals, provinces, municipalities, and other bodies will account for more than one-third of total federal government spending in 1984/5, and the proportion increases to nearly one-half if the cost of debt servicing is deducted. Those figures clearly indicate that redistribution programs constitute a large part of the federal government's role in Canadian society.

The subject under discussion at this conference is transfer payments to the provinces – more precisely, intergovernmental fiscal arrangements – precluding, consequently, any in-depth examination of income-security programs, many of which originate with the federal authority. It is sufficient for our purposes here to note that such programs derive directly from the redistributive power, which largely, though not totally, belongs to the federal government, and that on the whole they continue to have the worthwhile effect of providing all

Mr. Ryan is the member of the National Assembly of Quebec for Argenteuil and former leader of the Liberal Party of Quebec. He is also former editor of *Le Devoir*.

TABLE 1
Projected federal transfer payments to other levels of government, 1984/5 (in billions of current dollars)

	To all provinces[a]	To Quebec[b]
Equalization payments	$5.5	$2.9
Established programs funding	7.5	1.6
Canada Assistance Plan	3.7	1.1
Other programs	2.8	0.3
Total	$19.5	$5.9

a Figures taken from *Fiscal Plan* by Hon. Marc Lalonde, presented to Parliament 15 February 1984 along with the budget.
b Guideline figures obtained from the federal Department of Finance. According to the Quebec government's1984/5 budget, made public on 22 May 1984, the province's own projections of transfer payments are (in billions of current dollars):

Equalization payments	$3.102
Established programs funding	1.647
Canada Assistance Plan	1.179
Other programs	0.328
Total	6.256

Canadians with improved access to the economic, social, and cultural benefits of their society.

In 1984/5, the Canadian government's transfer payments to other levels of government, primarily the provinces, will total some $19.5 billion, more than one-fifth of the federal budget. Table 1 shows the distribution of this amount.

As shown in the note to Table 1, Quebec's portion is about 30 per cent of the total amount to be paid to the provinces in 1984/5. It will represent more than one-quarter of the Quebec government's revenues for that fiscal year. (If one includes revenues arising from the personal income tax 'points' related to the overall funding of established programs, the total transfer to Quebec will be approximately $8.3 billion, or more than one-third of the provincial government's probable expenditures for 1984/5. Of course, the calculation of personal income tax 'points' is a source of great friction between Ottawa and Quebec, and I do not intend to discuss it in this paper.)

Since the object of our discussions is to examine the regional impact of federal-provincial fiscal arrangements, I will present a few considerations from a perspective that is specifically one from Quebec. I will first offer some general comments on transfer-payment programs and then proceed to observations on each of the major programs covered by the fiscal arrangements.

AN OVERALL LOOK AT TRANSFER PAYMENTS

In Quebec, the federal-provincial fiscal arrangements have often provoked virulent criticism. But, in general, their underlying principle – a fair distribution of wealth – is widely accepted. For example, the present Quebec government has frequently criticized the manner in which fiscal arrangements have been conceived and applied. It has claimed the right to opt out of programs touching areas of provincial jurisdiction. But it has never, to my knowledge, questioned the principle of assigning the federal government an important role in the redistribution of wealth and opportunities.

Another example: during the Referendum campaign, the federal authority's role in redistributing wealth and opportunities was a major theme of the supporters of federalism and one of the most effective. Perhaps it was an easy image to evoke because the benefits of redistribution were readily demonstrable. But at the same time, Quebeckers were made to understand that come the day their province's wealth exceeded the national average, they, in turn, would be expected to help the residents of less fortunate regions. The logic was unquestioned.

The growth of transfer payments

Transfer payments of some type have been part of the Canadian federal tradition since Confederation. The form in which we know them today originated in the period following the Second World War.

These programs have enabled the governments of less wealthy provinces to provide their residents with services that otherwise would have been out of reach. In Atlantic Canada, federal transfer payments now represent more than half the revenues of the provincial governments. In Quebec, the proportion is 25 to 35 per cent (depending upon whether or not one includes the tax 'points' transferred to Quebec under the fiscal arrangements). If such

equalizing measures did not exist, the poorer provinces would either be burdened with insurmountable debt or be far behind in providing social and cultural development for their populations.

Programs introduced by the federal government in the areas of hospitalization, health care, and higher education have no doubt, by their very nature, raised serious constitutional and political difficulties. They have imposed numerous financial and administrative constraints upon the provinces. Yet they have allowed Canada to make major advances in the important areas of social and cultural policy. Had the federal government not exercised leadership in these three fields, only the wealthiest provinces would have been able to institute programs as advanced as those we now enjoy in Canada. And even in the rich provinces, the political will required to set up such programs might not have been manifested as early as it was.

On the whole, transfer programs have contributed to the provision of better-quality public services for the residents of all provinces. They have promoted greater equality of opportunity in the key fields of medical and hospital care, postsecondary education, and social assistance. They have mitigated the imbalances produced by the raw play of economic forces. They have helped to make Canadian society less brutal, more human, more concerned about sharing. In this respect, they deserve the support and admiration of all those who believe in this country. The sacrifices these programs have demanded of Canadians who are well endowed by geography and history were, and still are, totally justified by their beneficial returns for millions of other Canadians.

In recent years, however, some critics have claimed that the amounts the federal government pays out under the fiscal arrangements have become too heavy to support. We are told that transfer payments to the provinces have been a major factor in the growing deficits swamping the federal government.

The studies of the Breau Committee (the Parliamentary Task Force on Federal-Provincial Fiscal Arrangements [Canada 1981]) and of the Economic Council of Canada (ECC 1982) have made short shrift of these superficial opinions. These analyses show that if one excludes debt service, federal public expenditures have increased only very slightly in the last ten years in relation to Canada's gross national product. They also establish that the ratio of transfer payments to

total federal expenditures has remained almost constant over the last twenty years.

After examining all the available data, the Breau Committee and the ECC drew the following conclusions:

> Federal grants to provinces and municipalities expressed as a percentage of total federal spending have been fairly constant since 1970. There is, therefore, no ground to suggest that federal transfers have been getting out of control. In fact, they grew at a slower rate in the 1970s than they did in the 1960s. (Canada 1981, 33)

> While federal transfers to other levels of government account for a large portion of total federal spending (about 25 per cent), there is no reason to suggest that these expenditures played a particularly significant role in the escalating federal deficit during the period 1975-1981. . . . Federal transfers to other levels of government accounted for a roughly constant proportion of total federal spending (excluding interest payments) throughout this period. In fact, there has been little change in the shares of any one of the broad expenditure categories as a proportion of total federal expenditures over this period. (ECC 1982, 8)

The ECC concluded that the recent, spectacular rises in the federal deficit are not the result of increased spending on established programs but rather of failure to deal with the poor performance of the economy and of various fiscal measures, among which must be included the indexation of the personal income tax (a costly item for the federal government.)

Given these observations, I agree with the Breau Committee and the ECC that transfer programs are an essential and salutary element of our federal system of government, that their relative weight in federal budgets has remained constant for twenty years, and that they have become indispensable to the provision of good-quality public services and to the balancing of budgets in provinces whose economies are below the national average. Consequently, the federal government's financial involvement in these programs must continue, at least at its present level, as long as there exist the inequalities that presently characterize the economic situations of the provinces and the financial situations of their respective governments.

EQUALIZATION PAYMENTS

Among the programs that are covered by the present federal-provincial fiscal arrangements, equalization justifiably occupies the first place from the point of view of the recipient provinces because

such payments come with no strings attached, no special conditions or obligations. Equalization payments constitute a revenue supplement that the recipient province may use at its discretion to balance its finances and improve the quality of public services it provides for its citizens.

Thus, equalization payments are aimed at objectives that cannot be satisfied through taxation or transfer plans based on individuals. As the Economic Council of Canada rightly notes:

> The case in support of an intergovernmental system of equalization rests basically on the fact that the 'nominal' or 'market' income of Canadians living in different provinces does not reflect the additional benefits and/or costs that result from a myriad of provincial government policies and programs. To a varying extent from province to province, residents are the beneficiaries of goods and services provided by provincial governments or their agencies – for example, highways, health, education, welfare assistance, or subsidized electrical power. By the same token, residents are subject in varying measure to taxation to help cover the cost of providing such public goods and services. As a result of the variation in the impact of these costs and benefits across the country, persons with identical market incomes in different provinces may have quite different 'real' incomes after the net impact of provincial government activity is taken into account. . . . Since equity requires that Canadians in similar personal financial circumstances but living in different parts of the country be in a position to enjoy reasonably similar living standards, it is necessary to have in place an additional mechanism that is capable of reducing differences in the level of goods and services that provincial governments can provide to their citizens at some comparable level of costs. (ECC 1982, 26)

Equalization payments are the cornerstone of any policy for redistributing financial resources among the federal government and the provinces. This policy benefits the Atlantic provinces, Quebec, and Manitoba today, and until recently it benefited Saskatchewan. But if it had been in effect during the Great Depression of the 1930s, it would have favoured all the Prairie provinces. In the future, it might aid the provinces that now pay into the equalization pool for the benefit of others. Objective by definition, equalization favours any province in relatively difficult financial circumstances.

Thus, there is cause for rejoicing in the fact that the principle of equalization is now written into the Constitution. Section 36 of the Canadian Constitution, 1982, states:

> Parliament and the government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues

to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.

This solemn commitment appropriately confirms the obligation set out in the preceding paragraph of the same Section, which states that all governments are committed to

promoting equal opportunities for the well-being of Canadians; furthering economic development to reduce disparity in opportunities; and providing essential public services of reasonable quality to all Canadians.

But equalization cannot achieve its full meaning through a simple proclamation in the Constitution. It must also respond to three essential requirements: it must be *sufficient*, it must be *fair*, and it must be *stable*.

To have a truly significant effect, equalization must, above all, involve sufficient funds. It must provide subsidies that enable the recipient provinces to offer public services of suitable standards. Subsidy levels will certainly vary from one era to another, as well as in accordance with the general economic situation of the country and the financial circumstances of each province. But in every year the subsidy levels must be in line with the level of disparity among the provinces and with a generous view of what the quality of public services offered in all provinces of this country should be.

In this connection, it is interesting to note that between 1974 and 1984 equalization payments to Quebec rose at a significantly higher rate than did the overall budgetary revenues of the province. In 1973/4, equalization grants provided about 11 per cent of the budgetary revenues of Quebec; in 1983/4, they were in the neighbourhood of 15 per cent (see Table 2).

In view of the substantial readjustments that have affected grants to one province or another in certain years, it would be dangerous to isolate the figures for a particular fiscal year and try to draw general conclusions from them. What must be remembered is that the ratio of equalization grants to budgetary revenues of the Quebec government has generally tended to increase in the last ten years; the resulting curve reflects implied norms that it would be difficult to try to lower.

The current method of determining subsidy amounts is based on a formula known as the Representative Average Standard, which

TABLE 2
Equalization grants versus budgetary revenue, Government of Quebec, 1973/4-83/4

	Budgetary revenue (billions)	Equalization grants (billions)	Equalization grants as a percentage of budgetary revenue
1973/4	$5.754	$0.613	10.7%
1974/5	7.258	0.915	12.6
1975/6	8.364	1.035	12.4
1976/7	9.704	1.143	11.8
1977/8	11.133	1.272	11.4
1978/9	11.886	1.340	11.3
1979/80	13.277	1.709	12.9
1980/1	14.694	1.847	12.6
1981/2	17.482	2.318	13.3
1982/3	19.210	3.072	16.0
1983/4	21.350	3.183[a]	14.9

SOURCE: Service de recherches économiques de l'Opposition officielle, Assemblée nationale du Québec.
a According to more recent estimates, the yield of equalization grants for 1983/4 would seem to have been $3.227 billion.

encompasses some thirty-three sources of taxation. In a paper presented to the First Ministers' Conference on the Economy in 1982, the government of Quebec set forth a serious critique of the formula. (Gouvernement de Québec 1982). In particular, it asserted that:

1 Quebec had lost important sums of money through undercounting of the population in federal censuses.
2 Using population size as the sole indicator of the relative needs of each province does not reflect needs arising from the particular geography, demography, and cultural, social, and economic circumstances of each.
3 The tax bases for revenues from charges for public goods and services, property taxes, and miscellaneous sources, as well as for revenues from natural resources, are often arbitrary and seriously deficient.

4 The list of revenues subject to equalization is incomplete since it excludes municipal taxes and includes only half the revenues derived from nonrenewable resources.

Quebec proposed replacing the present formula with a much broader one that would take into account not only all sources of provincial and municipal revenues but also the spending needs of each province.

Instead, it was deemed preferable, no doubt for practical reasons, to keep the present formula and try to improve it. If we must keep that formula, Quebec is right in insisting that it should at least take into account *all* provincial and municipal revenue sources.

Moreover, if equalization is not ultimately to become a political football, it would be wise to add firmer guarantees of stability and continuity than those now in effect. Some latitude should always be provided to account for changes in the economy and in the financial situation of each province. But it would be highly advisable to subject the overall level of equalization payments to objective standards in order to avoid the impression that the sincerity of our commitment to the principle itself may be put in question every five years.

THE ESTABLISHED PROGRAMS: APPROACHES TO FUNDING

The three major programs commonly referred to as 'established programs' continue to be the focus of controversy, particularly with respect to federal participation in their financing.

These three programs – hospital care, medical care, and postsecondary education – cover fields that are provincial areas of jurisdiction. Believing that it should fulfil a 'national role' in these fields, a role that would become more and more important, the federal government succeeded over the years in circumventing the constitutional obstacle by awarding to the provinces conditional grants specifically earmarked for the implementation of such programs. Federal intervention in these fields was generally justified by a 'need to establish "national standards" so as to ensure access to a certain minimum level of essential services by all Canadians' (ECC 1982, 55).

Here is how the ECC explains the intervention of the federal government in two major areas:

In the field of health services:

The importance of establishing national health care standards was strongly emphasized by the Royal Commission on Health Services. Through the 'Health Charter for Canadians' proposed in its 1964 Report, the Commission underscored the importance of a comprehensive, universal health program for all Canadians. These objectives served as the basis of the federal conditions attached to the shared-cost medical insurance program that came into operation in 1968. More recently, the Honourable Emmett Hall, who served as Chairman of the 1964 Royal Commission, was again called upon to review health services in Canada. In his latest report he emphasized once more the need to maintain national health standards. (ECC 1982, 55)

In the field of postsecondary education:

In the absence of substantial federal support for postsecondary education, provinces might have been unwilling to devote adequate resources to this area since much of the benefits could accrue to other provinces because of the wide-scale migration of students and graduates. Beyond the broad support that it provides for postsecondary education generally under EPF, the federal government has also assumed responsibility for the financing of certain specific postsecondary activities where constitutional jurisdiction is less clear. These include research in the natural and social sciences, manpower training, student loans, and international educational support. (ECC 1982, 55)

Modes of funding

With its interventions in the vital fields of hospitalization (1957), health care (1968), and postsecondary education (1967 and 1972), the federal government was responding to widespread expectations among the population, particularly in the English-speaking provinces. But in so doing, it imposed its own priorities on the provinces in areas pertaining to their Constitutional jurisdiction. It bound them to obligations that would become very heavy in the future, requiring a significant amount of federal financial assistance.

Initially, the federal government and the provinces shared the costs of these programs equally. This formula, however, entailed serious risks of escalation for the federal treasury. For example, it had to pay for the costly collective agreements some provinces signed with their employees in the education and health fields. It was also forced to help fund numerous and potentially ill-advised innovations that the provinces introduced.

In 1977, agreement was reached on replacing the equal-cost-sharing formula for established programs with one of block financing, which involved both the transfer to the provinces of a significant

number (13.5) of personal income tax 'points' in return for reduced federal funding and federal cash payments tied to the cost of programs on the date the agreement came into force and to the gross national product.

The block-funding formula held three advantages for Quebec:

1 It confirmed the devolution of tax points heretofore obtained through opting out.
2 It eliminated, for all intents and purposes, administrative and financial controls.
3 It included an objective adjustment clause and guaranteed federal contributions.

Thus Quebec, like the other provinces, was not interested in changing the block-funding formula during the 1981-2 negotiations for the renewal of fiscal arrangements for the 1982-7 period. The federal government, however, felt quite differently. It was anxious not only to reduce its financial contributions to established programs but also to tie tighter controls to them. In Allan MacEachen's 1980 budget speech, the federal government began to reveal its intention to reduce transfers to the provinces, warning that it hoped 'to achieve significant savings' in this area (MacEachen 1980, 13). A further announcement expressed the desire for more effective monitoring over provincial use of the money paid out under the three major established programs.

In the 1981 and 1982 negotiations, the governments concluded an agreement to continue block financing, but conditions were added that left the door open for all sorts of unilateral actions on Ottawa's part. In the event, the federal government wasted no time in introducing changes that gave rise to unanimous condemnation by the provincial finance ministers in April 1983. During that brief period, the federal government had:

1 Abandoned the 'certainty principle', whereby each province knew in advance what to expect in transfer payments, and imposed cuts that caused federal payments to fall far short of cost increases.
2 Decided unilaterally to separate the funding of the postsecondary-education and the health programs, thereby contradicting the principle of block funding. First it divided its contri-

TABLE 3
Payments to Quebec under established programs funding, 1980-5 (in billions of current dollars)

	1980/1	1981/2	1982/3	1983/4	1984/5
Payments	$1.189	$1.226	$1.101	$1.720	$1.647

SOURCE: Service de recherches économiques de l'Opposition officielle, Assemblée nationale du Québec, May 1984.

bution to the two programs into arbitrarily set portions, and then it used this division to reduce arbitrarily its contribution to health programs.

3 Dangerously reduced the actual amount of its contributions to health services and postsecondary education.

For Quebec, 1983/4 brought sizeable increases in federal payments through changes in Statistics Canada's methods of calculating population and through the lower yield from tax 'points' related to established programs. But there had been a reduction in the yield from federal grants in 1982/3, and another is expected in 1984/5, as shown in Table 3.

According to the federal government's budget, its contributions to established programs, after having risen spectacularly but exceptionally for 1983/4, will drop slightly in 1984/5 and increase by 8 per cent in 1985/6 and 11 per cent in 1986/7. But this expectation assumes continuity in federal government policies with respect to financing established programs throughout the entire period. In view of what has occurred in the last three years, that is not at all certain.

In 1978, Mr. Trudeau had spoken to the provinces' desire for stability, acknowledging the need for more solid provisions in the fiscal arrangements to 'reduce the uncertainty which in the past has hovered over the question of continuity in the matter of federal participation and the amounts of federal contributions'. He stated that the federal government intended to 'emphasize permanency and stability in the new arrangements' (Trudeau 1978). Unfortunately, the federal government has strayed far from this line in the last three years.

THE ESTABLISHED PROGRAMS: ATTEMPTS TO MONITOR AND CONTROL

Financial instability resulting from changes in federal policies is only one of the difficulties that have arisen around the established programs. Quebec is much more concerned with the problems created by the federal government's expressed wish to monitor, control, and oversee the areas of health services and postsecondary education.

In the absence of an agreement between the federal and provincial governments during the negotiations preceding the renewal of the fiscal arrangements in 1982, one could only wait to see if the federal government's demands would take the form of direct initiatives. That is precisely what has begun to happen.

Health services

In the field of health services, the federal government's means of control were minimal after the block-funding method was adopted. But Bill C-3 sets out the federal government's intention to intervene directly in many areas of decision that are under provincial jurisdiction.

In its original version, Bill C-3 gave the federal government the right to define what constitutes mandatorily guaranteed services; to define adequate access to health services; to involve itself in delineating pay scales for doctors; to impose standards for its own visibility on the provinces; and to exercise increasingly predominant powers in the allocation of resources. The provinces were more or less relegated to the position of simple providers of services.

Some amendments were made to the bill following representations by the provinces. But the text adopted in the House of Commons continues to elicit strong objections from the provinces, most especially from Quebeckers involved in the health services.

For example, Pierre-Marc Johnson, speaking on behalf of the government of Quebec before the Senate Committee on Bill C-3 on 4 April 1984, stated that the main objections Quebec had presented to the Parliamentary Standing Committee on 21 February 1984 still held true, and that Bill C-3 as amended by the Commons committee was still unacceptable. Mr. Johnson explained:

It is not hard to predict the enormous consequences that such modifications will have on Quebec's role in the long-term planning and administration of its health system. The federal government will be able to determine accessibility of hospital services and details of transfer mechanisms, thus opening the door to escalating demands on each of the two levels of government by pressure groups. Not only would the federal government be free of any obligation to assume its share of the additional costs generated by such attempts to boost up the bidding, it could even reduce its contribution if it decided to side with the 'lobbies' opposed to the provincial government. Bill C-3 in all its absurdity institutionalizes a system one can only describe as almost designed to create federal-provincial conflict. . . . The amendments made to Bill C-3 do not answer Quebec's major claims in this regard. The consensual rule in hospital insurance has been abrogated for all practical purposes. The federal law alone will henceforth determine the conditions of transferability, user fees, and Quebec's obligation to guarantee and fund all services listed. The only safety valve in the federal government's regulating power provides that it may not exclude certain guaranteed services without the consent of the provinces . . . . Even worse, the amendments to Bill C-3 provide for mandatory arbitration in the matter of remuneration for doctors and dentists. This useless procedure, while optional, will cause new tensions, affecting as it does the labour relations field, which is exclusively provincial in jurisdiction. Quebec has a system of agreements with its health professionals; it has assumed and must continue to assume its responsibilities in this field without any interference from the federal government, which has no business meddling in relations between Quebec and its doctors and dentists. (Canada 1984, my translation)

Mr. Johnson's criticism of Bill C-3 was widely endorsed by the Quebec organizations and circles involved in health and hospital work. On the whole, his remarks were appropriate and well founded. The Canadian health program is threatened with distortion as a result of Bill C-3. One can only deplore this inopportune, arbitrary, and abusive federal legislation.

To justify their desire for increased control, the federal authorities invoked the need for more complete information on how the provinces were discharging their responsibilities. If the federal government means that it wants powers of enquiry and audit, such a claim contravenes the constitutional principle of the division of powers. On the other hand, if it means that the public and the Canadian Parliament should have fuller information on the provinces' performance, it should be reminded that the provinces already publish substantial documentation on the subject and, if need be, the scope of the data could be increased.

There should, however, be no question whatsoever of subjecting the provinces to any kind of federal tutelage with respect to the provision of health care. Doing so would be a step backward. The

federal government's recent claims in this area contravene the principle of federalism. They are not even justified by a fair scrutiny of the facts, as was clearly shown by the recent enquiry of Justice Emmett Hall (1980) on this matter.

Postsecondary education

The federal government believes that grants to the provinces for postsecondary education are actually being treated as unconditional subsidies. It suspects some provinces of using for other purposes the funds paid to them for postsecondary education. It would, therefore, like to apply stricter conditions to these grants.

During the 1982 First Ministers' Conference, Mr. Trudeau dealt with the subject directly. He stated that the federal government would be disposed to conclude a new agreement with the provinces regarding financial support for postsecondary education. But, he added, the new agreement – or any renewed agreement for 1983/4 – would carry the following conditions:

1 That the provinces undertake to increase overall funding of postsecondary education in each of the two following fiscal years by a rate equal to at least the rate of increase in cash and tax transfers granted under established program funding.

2 That the provinces undertake to discuss with the secretary of state mechanisms to achieve major national objectives for postsecondary education, 'objectives which would be defined in federal legislative provisions which would govern transfers for postsecondary education under established programs funding until the end of the fiscal year 1983/4' (Trudeau 1982).

Mr. Trudeau defined federal objectives for postsecondary education as follows:

Mobility: no preference based on province of origin, either for students or teachers.

Accessibility: reasonable guarantee of access to postsecondary education programs and adult training for all eligible Canadians.

Accountability: Sufficient information on postsecondary education programs to allow Parliament to ascertain the effectiveness of these funded programs and to permit national and international planning.

Joint planning: acceptance of joint federal-provincial planning of measures designed to achieve objectives set for postsecondary education and training.

Language: agreement to give all Canadian citizens the opportunity to perfect their knowledge of the official languages within the framework of formal education and, for official language minorities, to receive postsecondary instruction in their own language. (Trudeau 1982)

This set of criteria opens up a constitutional and political Pandora's box. Because of the confusion it creates regarding the responsibilities pertaining to each level of government and the ambiguous way in which it uses such expressions as 'national objectives', 'allow Parliament to ascertain the effectiveness of these programs', and 'acceptance of joint planning', it opens the door to increasing federal interference in university policy and, indeed, in curricula. It is likely to introduce at the university level the same degree of federal preponderance that Ottawa has acquired in adult vocational training policy through its greater financial means. From there to gradually imposing, by means of priorities established by the federal government, a philosophy of education overly concerned with responding to economic demands (as federal intervention already has done in postsecondary vocational training) could be a smaller step than we would like to believe.

Fortunately for the provinces, the studies required to implement the prime minister's intentions do not seem to have been completed. No official document has yet been issued by the federal government on the subject of new modalities for aid to postsecondary education.

Some provisions of Bill C-12, adopted in April 1984 by the House of Commons, indicate, however, that the federal government has not abandoned the intention expressed by Prime Minister Trudeau in 1982. Article 9 would oblige the secretary of state to submit to Parliament every year a report on the relationship between provincial expenditures for postsecondary education and 'national objectives'. He would also have to report on whatever consultations he had had with the provinces towards the definition of such 'national objectives'. The reference is, however, vague and hypothetical. A decision seems to have been made to proceed with extreme prudence in this area.

The federal government is reportedly considering giving direct grants to students, rather than paying out unconditional subsidies to

the provinces for postsecondary education. It is difficult to comment on such a proposal until it is concrete and all its implications have been carefully studied. At first glance, the proposed change would seem destined to become a source of instability and growing insecurity for universities and for the provincial governments, which have jurisdiction over postsecondary education according to the Constitution.

At the present time, the major problem for universities is underfunding, which is aggravated by the reduction of federal grants in constant dollars and by the severe budget cuts imposed by the provinces. In turn, underfunding generates its own well-known set of problems: delays in the modernization of scientific equipment, attrition and increases in the average age of faculty members, delays of investment projects, impoverishment of libraries and other cultural assets, and so on.

In constant dollars, Quebec's per-capita grants to universities in 1984/5 will be only 74 per cent of what they were in 1979/80. We cannot develop higher education by tightening restraints. Unlike most provinces, Quebec actually anticipates an increase in university enrolment over the next five to ten years. Our universities must have the resources they need to provide first-class training for their growing clientele.

In the sector of postsecondary education, the federal government should provide leadership of inspiration, encouragement, and support rather than leadership based on control and supervision. There is much to be done in developing federal aid for scientific equipment and greater access to higher education. If the federal government were to follow this path, it would be rendering a great service. If, on the other hand, it persists in seeking tighter controls, it will meet strong and well-deserved opposition in Quebec.

THE CANADA ASSISTANCE PLAN

The Canada Assistance Plan (CAP) is another major component of federal transfer payments. The CAP was conceived and operates as a program completely separate from the Unemployment Insurance Plan. This distinction was relevant in an era when most workers who collected unemployment insurance were able to re-enter the job market in a relatively brief period of time, while social-aid recipients

in the main were individuals unable to work for medical, social, family, or other reasons. For several years, however, because of the enormous increase in the number of unemployed and because of changes to the Unemployment Insurance Act introduced by the federal government, the lists of social-aid recipients have been swollen with thousands of people who are actually able to work. A large proportion of these people are less than thirty years of age.

In this new situation, the sharp distinction between insured and noninsured unemployed people no longer corresponds to reality. We must make every effort to find ways to encourage the unemployed who are able to work, to find work. To this end, social assistance, unemployment insurance, and taxation programs must be made as flexible as possible. Similarly, there must be greater equality among all people who are victims of forced unemployment. Given the new economic conditions and the swift, brutal, and radical changes they have caused, as well as changes in the type of training that must henceforth be available to workers of all ages, there must be better integration among income-security, manpower training and orientation, and tax policies.

It is to be hoped that revising the CAP will be on the agenda when all governments meet to discuss the fiscal arrangements for 1987-92. Once the matter is raised, they will quickly discover the need to examine many questions connected to the larger issues of income security and taxation.

SUMMARY

Perhaps the best way to summarize this paper is to draw some general conclusions about the fiscal arrangements.

That transfer payments from the federal government to the provinces are both necessary and beneficial seems indisputable. The redistribution of public funds in appreciable amounts is necessary to the harmonious functioning of the Canadian federation. Such redistribution is a primary responsibility of the federal Parliament and should be so effected.

The objectives, terms, and level of transfer payments should be founded as far as possible on a wide degree of consensus among the

governments concerned and should periodically be negotiated by them in good faith.

It is false to pretend that transfer payments to the provinces were a major cause of the spectacular growth of federal deficits in recent years.

Equalization payments must continue to be the cornerstone of the Canadian transfer-payment system. The formula for establishing the amount of the grants must be constantly reviewed. It should take into account not only the total tax capacities of the provinces but also their needs, which are often very different. For the foreseeable future, however, the first priority must be to maintain equalization payments at a level corresponding to the real needs of the country.

The 'national dimension' that originally justified federal intervention in hospital and health insurance programs and in higher education is still a valid concept, given the vital importance of health care and higher education to the future of our country and the costs that the provinces will have to absorb in these fields in the coming years. It is absolutely certain, consequently, that federal participation in the financing of these programs should be maintained – and at a level compatible with real needs. In the health field particularly, any reduction of the present level of federal participation would, in the words of the Breau Committee, 'risk leading to increased reliance on private funding and ultimately to higher health care costs and erosion of the program principles' (Canada 1981, xiii).

The block-financing method of determining the federal government's financial contribution to the three established programs (hospital insurance, health insurance, and postsecondary education), which was adopted in 1977 and retained in 1982, is the method best suited to ensuring that the provinces have the flexibility required for efficient operation of the programs involved. It should, therefore, be maintained, with appropriate guarantees of stability and continuity for the amount of federal financial contributions.

Provincial sovereignty in the fields of health and higher education must be clearly recognized and respected. Sovereignty here means primary and exclusive provincial jurisdiction over hospital- and health-insurance programs and the structuring and management

of higher education. Federal funding of these programs must not serve as a means of encroaching on areas of decision that are within the exclusive jurisdiction of the provinces.

- The pursuit of 'national standards' in certain programs that fall primarily under provincial jurisdiction cannot be rejected out of hand. On the contrary, it may be a valid justification for federal intervention. However, 'national standards' should be governed by an agreement among the governments concerned. The concrete search for those standards must be effected in ways that fully respect provincial sovereignty.

- The Canada Assistance Plan was designed to meet needs whose nature and importance have changed radically in recent years. In its present form, the plan gives rise to many inequalities and causes costly rigidities. It would be advisable to plan a major revision of the CAP with a view to the next fiscal arrangements. Better integration of the CAP with other federal and provincial income-security programs should be sought.

- Although the prevailing economic conditions and the financial position of the federal government make unlikely further major interventions in fields related to health, social policy, or education, we should not exclude future federal involvement in these sectors or in others that are primarily under provincial jurisdiction. In the light of experience gained since the Second World War, we can see that any new federal government intervention in fields of provincial jurisdiction should satisfy clearly defined conditions. It should:

1 Be based on the clearly expressed consent of a majority of the provinces representing at least 50 per cent of the Canadian population.

2 Provide for the freely chosen participation of each province in the proposed program. Nonparticipating provinces should be entitled to financial compensation equal to the costs that implementation of the program would have entailed.

3 Include clear, solid guarantees of stability and continuity with respect to the amount of federal financial participation.

4 Be stuctured so that program implementation and management comply fully with the sovereignty of the participating provinces.

As instruments for redistributing resources between the two levels of government, transfer payments have made a major contribution to creating a more satisfying way of life in all provinces of Canada. They have helped to provide the people of this country, wherever they reside, with public services of a quality that would not have been available to thousands if the provinces had had to manage alone.

Transfer payments have been very useful in the past. They are indispensable today. They will continue to be needed in the future. However, transfer payments must be prevented from becoming, in the hands of the central government, instruments of pressure or domination over the provinces. They must not be allowed to create between the provinces and the central power a dependency relationship that would be contrary to the spirit and the letter of the Canadian Constitution. Also of vital importance is the need for thorough discussions, held in good faith between the governments concerned, before any decisions are made with respect to the design or implementation of transfer-payment programs. These conversations will have more chance of success if they are imbued with civility and mutual respect and if they follow a tighter agenda and timetable than were evident during the last round of negotiations.

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Federal transfer payments: centralization or decentralization?

Robert L. Stanfield

It is obvious that the way in which you interpret the federal-provincial relations of the past twenty-five years depends considerably upon your biases, upon the kind of country you would like to see, and upon the degree of centralized power you consider desirable. When I read the works of Anglophone scholars, I generally (although certainly not always) sense a bias in favour of central authority, a disposition to believe that, relatively speaking, Ottawa is the seat of enlightenment and the source of progress. I sense, too, a readiness to find that Ottawa's authority is being eroded. When I read the works of Quebec scholars, however, I usually wonder if I am reading about the same country. (I am not referring to what Mr. Ryan said tonight, even though he is a scholar.) Because of this great disparity, I came to the conclusion some time ago that I must overcome my natural modesty and stick to my own biases, of which I have become increasingly fond with each passing year.

MONEY, POWER, AND THE ECONOMY

Another influence on your view of federal-provincial arrangements of the past few decades is the extent to which you blame these arrangements for the country's present economic and financial difficulties. Some people believe that in the 1970s Ottawa lost its capacity to regulate the economy through budgetary techniques because provincial

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revenues had grown in importance relative to its own and because a large percentage of Ottawa's expenditures had become nondiscretionary, governed by statutes based on federal-provincial arrangements.

My own opinion is that during the 1970s Ottawa lost not so much the power as the ability to regulate the economy satisfactorily. It tried a variety of methods to encourage growth and employment and reduce inflation, including throwing money at problems, and it is surely clear by now that it really did not know what it was doing. Thus, I do not believe that the cause of its ineffectiveness was the decentralization or rigidity of government expenditures. To be blunt, I do not believe we need these excuses, at least not yet in our present state of confusion. Indeed, to be very blunt, I think we should be thankful that Ottawa did not have more power, more control, during the 1970s. It did enough damage as it was.

REVENUE SHARING AND CONDITIONAL GRANTS

On the other hand, I look kindly on the arrangements made in the 1950s and 1960s to share revenues between Ottawa and the provinces, to 'equalize' them. Of course, the word 'equalize' has considerable rhetorical content, because revenues were never equalized, but the moves made during those decades went a long way towards enabling the provinces – even, or perhaps particularly, the least prosperous provinces – to discharge their responsibilities under the constitution.

Such revenue sharing was essential to the country. We might have adopted somewhat different formulae, as Mr. Ryan has suggested, but the only alternative to substantial revenue sharing would have been drastic centralization of constitutional responsibilities, a solution that was no more practical or acceptable in the 1950s and 1960s than it had been considered to be a hundred years earlier.

Provincial governments, of course, preferred – and I assume still prefer – unconditional revenue sharing to conditional federal grants tied to particular programs. Such grants, the provincial governments felt, might distort their own financial priorities. Canada is, after all, a diverse country, and a province might well have more urgent needs than those Ottawa is willing to share the costs of meeting; yet it is politically difficult for a provincial government to

leave conditional federal grants unused. Furthermore, conditional grants tied to particular programs can create financial insecurity for provinces because it is not unknown for Ottawa to discontinue financial support for programs after they are launched, leaving the provinces holding the bag. For example, in the 1960s, provincial premiers, including John Robarts, were very concerned that Ottawa might modify its financial support of medicare as the costs grew. And Ottawa did.

One can easily understand the attractiveness to Ottawa of conditional grants, compared to simple revenue sharing. Ottawa naturally likes to get something it wants or believes the country needs, even within areas of provincial jurisdiction. But this use of the federal spending power has usually been an irritant to all the provinces and always anathema to Quebec. In the 1960s, Ottawa tailored some programs to meet Quebec's objectives; the special measures included the right to opt out. Other provinces went along with the federal proposals, in some cases because they felt they had no practical alternatives. Yet an unfettered spending power is hardly consistent with a division of powers. I recognize the role jointly developed programs play in our system of government, but the subject of safeguards on the federal exercise of the spending power, which were discussed in the great constitutional-discussion binge we had in the late 1960s and early 1970s, will have to be resumed some day. In the meantime, Ottawa's spending power will not be a source of acute concern to most provinces as long as Ottawa is poor.

REVENUE SHARING AND CENTRALIZATION

The unconditional fiscal arrangements increased revenues for the provinces, but it by no means follows that these arrangements put the provincial governments in a financial position, relative to their functions, that is easier than the federal government's. Most provinces are in severe financial straits. We are all too well aware of the way the provinces are retrenching on education. It is by no means obvious that Ottawa's expenditures are more important to the people than are the provinces'.

It must also be remembered that much of the increased provincial expenditure of the past twenty years has been in support of joint programs launched and tailored by Ottawa. The great health

and welfare programs of the 1950s and 1960s brought large provincial expenditures under basic federal control. Federal politicians complain that they do not have much control, but we have seen a significant exercise of it in the imposition of the recent Canada Health Act. A more fundamental point is that Ottawa launched its joint programs in the 1950s and 1960s not to help the provincial governments but rather to serve the national objectives it wished to pursue. In a very real sense, Ottawa harnessed the provinces to serve its own purposes. It reduced its own financial flexibility in the process, but it did so by extending its power, not by abandoning it.

Now I am not arguing the merit of these joint programs or their quality or the need for them. I am simply saying that they were centralizing in conception and in effect. And I would also remind you that the provinces needed vastly increased revenues to pay for them.

My line of reasoning may convince you that, as I said at the outset, centralization is in the eye of the beholder. Pierre Trudeau became prime minister believing that too much had been conceded to the provinces, perhaps particularly to the province of Quebec, during the 1960s. Some people describe the 1970s as a period of decentralization. I reject that view. Mr. Trudeau took office determined to exercise federal jurisdiction, and he did so. He yielded no constitutional power to the provinces in the 1970s. True, provincial governments grew in importance to their people during that decade, but the federal government was not exactly a shrinking violet. Many people believed it was trying to do too much. Having gotten out of the bedrooms of the nation in the 1960s, it entered a lot of other rooms in the 1970s.

Although I do not think that Ottawa lost constitutional power during the 1970s, I would agree that it lost influence. One reason was that it could not fulfil the great expectations that had been created. Another reason was that Ottawa did not seem to be able to cope effectively with national economic problems or, indeed, with regional ones; the Department of Regional Economic Expansion (DREE), for example, was not a howling success. A third reason was citizens' increasing cynicism towards government, a widespread phenomenon in the western world.

A final important reason was that Ottawa ran out of money with which to influence the provincial governments. During the 1960s, assuming that rapid economic growth would continue, it

overcommitted itself, launching great national plans in areas within provincial jurisdiction; by the mid-1970s, it was modifying the financial commitments it had made to the provinces under some of these plans. However, this drawing back was not exactly a surrender of power, and the ensuing arguments hardly created sweetness and light.

FEDERAL-PROVINCIAL TENSIONS

Thus, what we saw in the 1970s was not decentralization but a phenomenal increase in tensions between Ottawa and provincial governments. This was, in part, over money. Also, the decade's great emphasis on constitutional discussions concentrated the provincial premiers' attention on their points of difference with Ottawa and fostered continuing unease about possible grabs by Ottawa. We had a flowering of Quebec nationalism, following the running skirmishes and occasional battles between Ottawa and that province in the 1960s. And throughout the 1970s, we had horrendous rows over petroluem, which caused the provinces that produce it to attach ever greater importance to their constitutional rights. We saw stark confrontation, with the party now in power in Ottawa finally running an election against Alberta. You cannot go much further than that in asserting federal authority, short of sending in the troops.

I agree with those analysts who point out that these struggles between Ottawa and the provinces had a strong regional flavour. Note that neither the dispute over language nor those over petroleum pitted Ottawa against the provinces *en masse* or weakened the position of the federal government vis-à-vis the provinces as a whole. English-speaking Canadians did not side with the Parti Québécois against Ottawa. In fact, the perceived threat to the nation created by the Parti Québécois was one of the few factors at work in the 1970s that increased Ottawa's influence among most Canadians. Another was the dispute over petroleum prices and revenues. Central and eastern Canadians supported the exercise of central power against the West. And so did a goodly proportion of provincial government officials, at least in their bedrooms.

Now I believe that all this confrontation badly damaged the country. But Ottawa's rows with Quebec and with the Western provinces increased centralist sentiment among most voters and

encouraged the federal government to exert power rather than to relinquish it.

CONCLUSION

One might argue from all this that to be in a strong position Ottawa needs not more constitutional powers but either more money to spend or some development that seems to threaten most Canadians. The existing economic and financial mess may will fill the bill in the 1980s.

Certainly the country is now threatened by grave financial and economic problems. Canadians may well feel that in confronting these dangers we are all in the same big boat, whose seaworthiness and efficiency must be our number one concern. Maritimers will not abandon their hopes for a stronger Maritime economy, but they realize that achieving it requires a healthy Canadian economy. Citizens of Ontario know that a prosperous Ontario requires a prosperous Canada. Others here can speak for Quebec and the West, but one senses a realization in both regions that we have to get our economy and our finances in order.

I hope no one in Ottawa is going to be foolish enough to use this emergency to try to shoot regional demons. Canada is a country of regions -- of diversity. If we do not respect this, we will build nothing but trouble for the future.